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No. 91-1451

IN THE

Supreme Court of the United States

October Term, 1991

MESA PETROLEUM CO., et al.,

Petitioners,

v.

DAVID COLAN and UNOCAL CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

Unocal's Opposition (cited herein as "Opp. at __") would have this Court believe that the Ninth Circuit's decision poses no conflicts with this Court's decision in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), nor with the numerous decisions of the Second and other Circuits cited in the Petition. The conflicts are real, and §16(b) law will be left in substantial confusion unless the writ is granted.

Kern County is universally regarded as a landmark case in securities law jurisprudence, and the Ninth Circuit should not be permitted to undercut so important a precedent. *Kern* and this case are not distinguishable in any material factual respect. But even if *Kern* were "factually distinguishable," it is far more important that the two cases are not distinguishable *legally*.

Contrary to Unocal's suggestion, it is well settled, particularly after *Kern*, that "mechanical" application of §16(b)'s "flat rule" is limited to "garden variety" transactions. Transactions that are not garden variety — which this Court labeled "unorthodox" or "borderline," 411 U.S. at 593, 594 — are considered statutory "sales" under §16(b) *only* if they present an opportunity for the speculative abuse of inside information — the sole evil addressed by the statute. *Id.*

Mesa's petition presents the single question whether its economically coerced exchange of Unocal stock for Unocal bonds pursuant to Unocal's recapitalization was a "sale" for purposes of §16(b).[1] The district court held first that Mesa's exchange was unorthodox rather than garden variety and second that that

[1] Unocal nonetheless talks at length about Mesa's *purchase* of Unocal stock, including unsubstantiated accusations of "greenmail," "parking," "disguised" purchases and "arrangements with convicted securities felons." Opp. at 3-4, 12, 28-29. As Unocal admits, these accusations are both irrelevant to the question before this Court and disputed by Mesa. Opp. at 4.

unorthodox transaction was not a §16(b) "sale," since it did not present Mesa with any opportunity to abuse inside information. The Ninth Circuit reversed, with a categorical holding that the exchange was *not* an unorthodox transaction because it was neither "involuntary" nor pursuant to a merger. The Ninth Circuit then concluded that it need not even consider the issue of whether Mesa had the opportunity to abuse inside information.[2]

Contrary to Unocal's assertions, the Ninth Circuit's opinion undermines *Kern* in several respects. It tries to limit *Kern's* effect to the specific facts of that case (Pet. at 22a) and confines the unorthodox transaction approach to an "involuntary transaction that results from a merger." Pet. at 29a. In so doing, the Ninth Circuit (1) ignores the basic thrust of *Kern*, which is to analyze whether the nature and circumstances of the transaction in question presented an opportunity for abuse of inside information by the particular defendant and (2) dismisses as irrelevant *Kern's* oft-cited footnote 24, which lists illustrative types of transactions (in addition to mergers) that are not garden variety.

Moreover, the Ninth Circuit's decision exacerbates a conflict among the Circuits as to whether *Kern* requires involuntariness as an essential element in holding a transaction to be outside the scope of §16(b). In addition, insofar as involuntariness is to be considered in the analysis (whether or not as an essential element), the Ninth Circuit's decision exacerbates a conflict among the Circuits as to what constitutes involuntariness. The conflicts are particularly sharp between the Ninth Circuit's decision in this case and several decisions of the Second Circuit.[3]

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[2] Not once does Unocal even suggest that Mesa's exchange could have conceivably provided Mesa with any opportunity to abuse inside information about Unocal (even if Mesa had had access to any such information, which Unocal concedes is not the case).

[3] Unocal asserts that *Kern's* "principles have been *consistently* applied in a myriad of decisions throughout the federal judiciary . . . ." Opp. at 2 (emphasis supplied). The author of the §16(b) treatise on which

Unocal's Section II — Conflicts With *Kern*.

The Ninth Circuit's Limitation of *Kern* to Mergers. Unocal attempts to avoid the collision with *Kern* by repeatedly arguing that the Ninth Circuit did *not* limit the unorthodox transaction analysis to involuntary exchanges pursuant to mergers.[4] Unocal's palliative assertions cannot be reconciled with the words of the Ninth Circuit's express holding: "We conclude that the facts in this matter do not come within the holding of *Kern County* that [1] an *involuntary* transaction [2] that results from a *merger* is 'unorthodox.'" Pet. at 29a (emphasis and brackets supplied). Nor can Unocal's characterizations be squared with numerous other passages in the Ninth Circuit's opinion. *See, e.g.*, Pet. at 24a (Mesa's exchange "not an involuntary or automatic transaction" compelled by merger); 27a ("not the inexorable consequence of corporate machinations that forced the stockholders to exchange their shares . . . "); 29a ("*Kern County* simply held that an automatic exchange . . . pursuant to a merger" is outside § 16(b)).[5]

***Kern's* Footnote 24.** Contrary to Unocal's characterization (Opp. at 15-16), Mesa does not argue that inclusion of a type of transaction in *Kern's* footnote 24 is by itself sufficient to exclude a transaction from § 16(b). Only those "unorthodox" transactions

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Unocal repeatedly relies, however, disagrees. *See* A. Jacobs, *Section 16 of the Securities Exchange Act* §3.04[5][a] at 3-107 (1989) (observing that courts have adopted inconsistent approaches in applying the unorthodox transaction doctrine "[b]ecause all judges do not read *Kern County* the same way").

[4] *See, e.g.*, Opp. at 15 (did not "purport to limit or confine *Kern* to mergers"; did not hold "unorthodox transaction exception could *only* be applied to involuntary transactions"); 21 ("did not hold that involuntariness is a *necessary* element of the unorthodox transaction exception, or that the unorthodox transaction exception is limited to forced mergers") (emphasis in original).

[5] As to Unocal's citation (Opp. at 15) to the Ninth Circuit's statement that the "majority" of the unorthodox transaction cases involve mergers, see Pet. at 16 n.23.

which present no opportunity for speculation based on inside information fall outside § 16(b)'s scope. Footnote 24 was this Court's listing of the kinds of "unorthodox" or "borderline" transactions — as distinguished from "garden variety" or "traditional cash-for-stock" purchases and sales — that federal courts had theretofore analyzed and that, according to this Court, *should* be analyzed to determine whether or not they provide an opportunity for such speculation. *See* Pet. at 15-16. Unocal suggests (without authority) that *Kern's* footnote 24 was not intended by this Court to have any significance. Opp. at 15. But the lower courts have taken footnote 24 as a basic reference point for the "unorthodoxy" analysis, while recognizing that the list is not exhaustive or all-inclusive. *See* Pet. at 16-17.[6] We are aware of no opinion, other than the Ninth Circuit's opinion here, that simply brushes aside the footnote as irrelevant.

Factual Parallels with *Kern*. Unocal sets forth an eight-point list of supposed factual differences from *Kern*. Opp. at 13-14. Half of the items — nos. (1), (3), (5) and (6) — relate to the "involuntariness" issue, which is addressed below and in the Petition.[7] Each of the other suggested distinctions (numbered here as in Unocal's list) is either legally irrelevant, unsupported by the record or based on a misreading of *Kern:*

> (2) The allegation that Mesa planned for a short-term investment is both unsupported by the record (as evidenced

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[6] Jacobs notes that "lower courts have adopted footnote 24 as a statement of law," Jacobs, § 3.04[2] at 3-75, and that "[t]he best test is to include within 'unorthodox transactions' those transactions in footnote 24 of *Kern County*, as we have added to them . . . . " *Id.* at 3-77.

[7] Unocal's footnote 22 (Opp. at 11 n.22) completely evades the principal focus of *Kern's* discussion of the Occidental/Tenneco option. *Kern* clearly held that the option — an entirely voluntary transaction — was not a "sale" by virtue of the unorthodox transaction analysis. *Kern*, 411 U.S. at 601-04; *see also* Pet. at 14. Unocal's footnote 22 erroneously suggests that the alternative basis for the Court's holding on the option (i.e., that it did not constitute a sale in fact) was the only basis.

by Unocal's failure to cite any authority) and legally irrelevant. *See Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972).

(4) Unocal nowhere explains why there is a meaningful distinction between Occidental's exchange of common stock for preferred stock in an entirely different company and Mesa's exchange of stock for debt securities issued by the same company.

(7) Claims of Mesa's "substantial bargaining power" and "leverage" used to "extract substantial concessions" are unsupported by Unocal's authority and are directly contradicted by the record. *See* Pet. at 54a. Moreover, this Court observed in *Kern* that if Occidental had leverage in dealing with Tenneco, it was irrelevant since it was attributable to Occidental's "large stock ownership itself," not to "inside information." 411 U.S. at 602.

(8) A "shrewdly calculated business decision" was also made by Occidental. *See* Pet. at 13-14.

The facts of this case are not different in any material respect from those of *Kern*. *See* Pet. at 12-15.

Unocal's Section IV — Conflicts With Other Circuits.

Recapitalizations and Tender Offers. The unorthodox transaction approach does not require that the recapitalization cases cited by the parties be analyzed to determine the precise similarities and differences between Unocal's recapitalization and the ones in those cases.[8] The point is simply that, under *Kern's*

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[8] Contrary to Unocal's assertion (Opp. at 19), however, Mesa *did* continue its equity investment in Unocal. Following the Exchange Offer (which applied to about one-third of a holder's total shares), Mesa's ownership percentage of the reduced number of total outstanding Unocal shares was essentially the same as it was before the transaction (about 13.6%). Pet. at 40a. Also, contrary to Unocal's

footnote 24 and decisions of the Second Circuit (*see* Pet. at 17-18), an exchange pursuant to a recapitalization is not a garden variety transaction and must therefore be analyzed to determine whether the defendant had an opportunity for speculative abuse.[9] Whether a recapitalization results in a "change in the nature of the investment" (an imprecise phrase, at best) is a red herring. In *Kern* itself, as noted above, the nature of Occidental's investment fundamentally changed.[10] *See* Pet. at 17 n.26.

The cases do not support Unocal's purported "universal rule" that exchanges in tender offers are always § 16(b) sales (Opp. at 19-20) — as evidenced by Unocal's lack of case law support therefor.[11] In fact, the Ninth Circuit acknowledged that an exchange in a tender offer had been held unorthodox. Pet. at 31a.

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assertion (Opp. at 20), the Exchange Offer, did involve what the Second Circuit described in *Blau v. Lamb*, 363 F.2d 507, 523 (2d Cir. 1966) (cited with approval in *Kern*, 411 U.S. at 594 n.26), *cert. denied*, 385 U.S. 1002 (1967), as a recapitalization: "that which the insider surrenders and that which he receives are simply different forms of the same participation in his issuer."

[9] The Jacobs treatise, which Unocal cites so frequently, agrees: Recapitalizations are unorthodox transactions, Jacobs, § 3.04[5][f] at 3-177, which do not give rise to § 16(b) liability as long as "all stockholders are treated equally and receive a security of the company in which they had invested." *Id.* at 3-186.

[10] Unocal is wrong in asserting (Opp. at 20) that "no case has ever held that an exchange of equity securities for debt instruments" is within the unorthodox transaction doctrine. *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,693 (S.D.N.Y. 1980) (cited in Pet. at 18), so held as to a recapitalization involving an exchange of convertible debt securities (which are equity securities under § 16(b); *see* Opp. at 20 n.44) for non-convertible debt securities.

[11] The only Court of Appeals decision that Unocal cites in its effort to demonstrate such a rule is *Blau v. Lehman*, 286 F.2d 786 (2d Cir. 1960), *aff'd*, 368 U.S. 403 (1962), but even if the recapitalization transaction there could be labeled a tender offer (which is not clear from the opinion), it involved no economic coercion or other involuntariness. Neither *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F. Supp. 1196 (S.D.N.Y. 1981), nor *Tyco Laboratories, Inc. v. Cutler-Ham-*

Involuntariness. The Ninth Circuit concluded that Mesa's exchange was "voluntary" because (1) Mesa "voluntarily" negotiated to overcome Unocal's discrimination against it and to obtain permission to participate in the Exchange Offer, (2) Mesa had the "alternative" of mounting a larger tender offer and (3) having obtained permission to participate in the economically coercive Exchange Offer, Mesa "voluntarily" tendered its shares. The Petition demonstrates the conflicts that the Ninth Circuit's decision poses with *Kern* and with decisions of other Circuits on each of these three indicia of "voluntariness."

With respect to the first, the Opposition completely ignores the Ninth Circuit's conflicts with *Kern County* and with *Colan v. Continental Telecom, Inc.*, 616 F. Supp. 1521 (S.D.N.Y. 1985), *aff'd without opinion*, 788 F.2d 2 (2d Cir. 1986), under both of which Mesa's "negotiations" are irrelevant. *See* Pet. at 23. As to the second type of "voluntariness," Unocal's discussion of *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157 (2d Cir. 1971), *aff'd sub nom. Kern County*, and *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975) (Opp. at 25-26), does not respond to the fact that the Second Circuit held in each case that the alternative of making another tender offer is irrelevant.[12] *See* Pet. at 23-24.

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mer, Inc., 490 F. Supp. 1 (S.D.N.Y. 1980), involved a sale in a tender offer; each involved a sale in a transaction available only to the defendant, who happened to be a defeated corporate suitor.

[12] Unocal also invents two other irrelevant "alternatives" that Mesa supposedly had. Opp. at 25-26; *see also* Opp. at 5 n.9. First, Unocal argues that Mesa could have avoided the loss imposed by nonparticipation in the Exchange Offer if it had held its stock for 4½ years, a period selected by Unocal. As the District Court concluded (on a point the Ninth Circuit did not address), hindsight should not be applied to determine whether a statutory insider would have realized a better or worse financial outcome if it had held its stock for any particular period beyond the statutory six months; a court applying § 16(b) must be concerned with the facts as they existed at the time the decision in question was made. Pet. at 53a. Second, Unocal claims (without any support in the record) that Mesa could have

Regarding the Ninth Circuit's conflict with other Circuits as to whether economic coercion makes a transaction that is voluntary in form "involuntary" for purposes of § 16(b) (*see* Pet. at 24-25), Unocal's response is inconsistent and misleading. First, immediately after claiming that *Kern* "mooted" the pre-*Kern* cases of *Ferraiolo v. Newman,* 259 F.2d 342 (6th Cir. 1958), *cert. denied,* 359 U.S. 927 (1959), and *Petteys v. Butler,* 367 F.2d 528 (8th Cir. 1966), *cert. denied,* 385 U.S. 1006 (1967) — two of the five cases that were specifically cited with approval in *Kern's* footnote 26; *see* Pet. at 19 — Unocal twice cites another pre-*Kern* case that is favorable to Unocal's position regarding economic coercion. Opp. at 23 nn.46 & 47 (citing *Western Auto Supply Co. v. Gamble-Skogmo, Inc.,* 348 F.2d 736 (8th Cir. 1965), *cert. denied,* 382 U.S. 987 (1966)). *Western Auto,* which was not cited at all in *Kern,* is simply further evidence of the conflict among the Circuits.[13] Unocal then asserts that two decisions of the Second Circuit have "resoundingly rejected" economic coercion arguments. Opp. at 23 (citing *Heublein, Inc. v. General Cinema Corp.,* 722 F.2d 29 (2d Cir. 1983), *cert. denied,* 465 U.S. 1066 (1984), and *American Standard).* Neither case had anything to do with economic coercion; both were merger cases in which *Kern* was applied.

Second Circuit Cases. Unocal's excerpt from *Perine v. William Norton & Co.,* 509 F.2d 114 (2d Cir. 1974) (Opp. at 26-27), is out of context. *Perine* in fact supports Mesa's argument and further evidences the conflict between the Ninth Circuit's holding

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negotiated a sale within the six-month period that would have somehow "become effective" thereafter. It is well settled that §16(b) liability cannot be avoided by such a formalistic device. *See, e.g.,* §3(a)(14) of the 1934 Act ("sale" includes a contract to sell); *Bershad v. McDonough,* 428 F.2d 693 (7th Cir. 1970), *cert. denied,* 400 U.S. 992 (1971).

[13] *Western Auto* could not have "eschewed an opportunity" to interpret *Petteys* differently (as Unocal claims; Opp. at 23 n.46), since *Western Auto* was decided prior to *Petteys.*

here and the jurisprudence of the Second Circuit. In *Perine*, the Second Circuit, because of the absence of opportunity for abuse, held that the underwriter's sale was exempted by Rule 16b-2, 17 C.F.R. § 240.16b-2, 509 F.2d at 121 — despite the fact that the exemption would not be available if the Rule were applied literally. *Id.* at 119.

Unocal's quotation from *Heublein* (Opp. at 27-28) also further supports Mesa's position and further evidences the conflicts with the Second Circuit. The only difference between the three conditions listed in the *Heublein* quotation and the facts of this case is that an exchange in a merger is involuntary in form as well as substance, while Mesa's exchange in the economically coercive Exchange Offer was involuntary in substance but not form.[14]

Unocal's Section V — Defeated Tender Offerors.

Unocal's Section V creates a straw man. The Petition does not assert that Mesa's exchange was exempt from § 16(b) solely by virtue of the fact that Mesa was a defeated tender offeror. Mesa's argument — and the cases cited in its Petition that conflict with the Ninth Circuit's decision — turn on the nature of the *transaction*, as well as the status of the defendant. *See* Pet. at 20-21.[15]

Unocal also asserts that the failure of the Securities and Exchange Commission to promulgate a rule exempting transac-

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[14] None of the three district court cases cited at Opp. at 28 involved economic coercion or any other kind of "involuntariness."

[15] Interestingly, however, the Jacobs § 16(b) treatise advocates a far broader "exemption" than the one Unocal attributes to Mesa's advocacy. Noting that § 16(b)'s sole purpose "is to prevent insiders from using inside information unfairly," Jacobs observes that "[a]n insider cannot unfairly use inside information if he can control the transaction but has no access to inside information, nor can he unfairly use inside information if he has access yet cannot control the transaction." Jacobs, § 3.04[5][a] at 3-108. Jacobs therefore concludes that "the better view is to deem an unorthodox transaction to be a Section 16(b) purchase or sale unless, as to the insider, the transaction was involuntary *or* he had no access to inside information." Jacobs, § 3.04[5][b] at 3-130 (emphasis in original).

tions such as this one from the coverage of § 16(b) is determinative. Opp. at 29. If Unocal's argument were correct, every case that has held an unorthodox transaction to be outside of § 16(b) (including *Kern County*) would be wrong. Indeed, since 1952 and well before *Kern*, a Commission rule has exempted dispositions pursuant to certain kinds of mergers. Rule 16b-7, 17 C.F.R. § 240.16b-7. Yet the disposition pursuant to the merger at issue in *Kern* was held not to be a § 16(b) "sale," even though the *Kern* merger was *not* within the coverage of Rule 16b-7.

Conclusion

For the reasons set forth above and in the Petition, the writ of certiorari should be granted.

Respectfully submitted,

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